

Exhibit No.:

Issue(s):

Record Keeping Requirements

Filing Requirements

Witness/Type of Exhibit:

James R. Dittmer/Rebuttal

Sponsoring Party:

Office of the Public Counsel

Case No.:

WM-2001-309

REBUTTAL TESTIMONY

OF

JAMES R. DITTMER

FILED

JUN 26 2001

Missouri Public
Service Commission

Submitted on Behalf of
the Office of the Public Counsel

**MISSOURI-AMERICAN WATER COMPANY,
ST. LOUIS COUNTY WATER COMPANY
D/B/A MISSOURI-AMERICAN WATER COMPANY, AND
JEFFERSON CITY WATER WORKS COMPANY
D/B/A MISSOURI-AMERICAN WATER COMPANY**

Case No. WM-2001-309

June 26, 2001

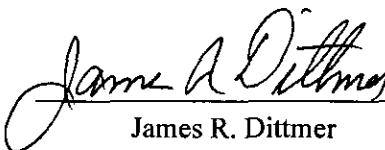
**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the matter of the Joint Application of Missouri-)
American Water Company, St. Louis County)
Water Company d/b/a Missouri-American Water)
Company and Jefferson City Water Works)
Company d/b/a Missouri American Water)
Company for authority to merge St. Louis County)
Water Company d/b/a Missouri-American Water)
Company and Jefferson City Water Works)
Company d/b/a/ Missouri-American Water)
Company with and into Missouri-American Water)
Company and, in connection therewith certain)
other transactions.)

WM-2001-309

AFFIDAVIT OF JAMES R. DITTMER

James R. Dittmer, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Direct Testimony of James R. Dittmer"; that said testimony and schedules were prepared by him and/or under his direction and supervision; that if inquires were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge.



James R. Dittmer

State of Missouri

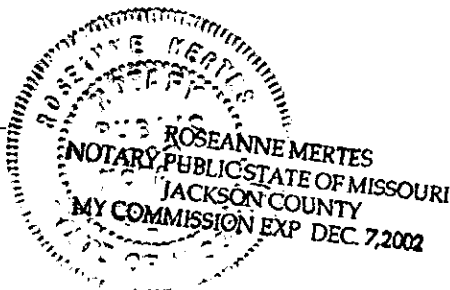
County of Jackson

SUBSCRIBED and sworn to

before me this 25 day of June, 2001


Notary Public

My commission expires: 12-7-02



**DIRECT TESTIMONY OF
JAMES R. DITTMER**

**PRESENTED ON BEHALF OF THE
MISSOURI OFFICE OF THE PUBLIC COUNSEL**

**In the Matter of the Application to Merge
St. Louis County Water Company and Jefferson City Water
Works Company with Missouri-American Water Company
Case No. WM-2001-309**

1 Q. Please state your name and address.

2 A. My name is James R. Dittmer. My business address is 740 North Blue Parkway, Suite 204,
3 Lee's Summit, Missouri 64086.

4
5 Q. By whom are you employed?

6 A. I am a Senior Regulatory Consultant with the firm of Utilitech, Inc., a consulting firm
7 engaged primarily in utility rate work. The firm's engagements include review of utility rate
8 applications on behalf of various federal, state and municipal governmental agencies as well
9 as industrial groups. In addition to utility intervention work, the firm has been engaged to
10 perform special studies for use in utility contract negotiations.

11
12 Q. On whose behalf are you appearing?

13 A. Utilitech, Inc. has been retained by the Office of the Public Counsel for the State of Missouri
14 (hereinafter "OPC"). Thus, this testimony that I am presenting is being filed on behalf of the
15 OPC.

16
17 Q. What is the purpose of your testimony in this proceeding?

18 A. In a May 3, 2001 dated rate order for St. Louis County Water Company ("SLCWC"), this
19 Commission directed SLCWC to create and maintain a Cost Allocation Manual ("CAM") in
20 order that charges from American Water Works Service Company ("AWWSC") could be
21 more efficiently reviewed, analyzed and tested for reasonableness. One purpose of this

1 testimony is to simply recommend and hopefully insure that the requirements that were placed
2 upon SLCWC as a directly owned Missouri-American Water Company subsidiary will, in
3 turn, be placed upon Missouri-American Water Company – the surviving company following
4 the planned merger of SLCWC and Jefferson City Water Works Company ("JCWWC") into
5 Missouri-American Water Company.

6
7 Second, I am recommending that the various reporting requirements of the CAM which this
8 Commission directed SLCWC to implement regarding AWWSC allocations be directed
9 "downstream" to the existing and newly-created-pursuant-to-the-proposed merger "districts"
10 of Missouri-American Water Company. Very simply, I am recommending that the various
11 statistics and other reporting requirements that should be kept for the AWWSC CAM, be in
12 turn kept at the Missouri "district" level so that appropriate assignment and allocation of
13 AWWSC costs to Missouri-American Water Company can, likewise, be consistently and
14 equitably allocated to each benefitting Missouri district.

15
16 Finally, to the extent there are joint or common costs incurred at the "Missouri American
17 Water Company" level for the benefit of only the Missouri "districts," I am recommending
18 that documentation being maintained for the AWWSC CAM also be created and maintained
19 in comparable detail for such "common Missouri" costs.

20 21 **Qualifications**

22 Q. Before further explaining your various recommendations, please state your educational
23 background?

24 A. I graduated from the University of Missouri - Columbia, with a Bachelor of Science degree
25 in Business Administration, with an Accounting Major, in 1975. I hold a Certified Public
26 Accountant Certificate in the State of Missouri. I am a member of Beta Alpha Psi National
27 Accounting Fraternity, the American Institute of Certified Public Accountants, and the
28 Missouri Society of Certified Public Accountants.

1 Q. Please summarize your professional experience.

2 A. Subsequent to graduation from the University of Missouri, I accepted a position as auditor
3 for the Missouri Public Service Commission. In 1978, I was promoted to Accounting
4 Manager of the Kansas City Office of the Commission Staff. In that position, I was
5 responsible for all utility audits performed in the western third of the State of Missouri.
6 During my service with the Missouri Public Service Commission, I was involved in the audits
7 of numerous electric, gas, water and sewer utility companies. Additionally, I was involved
8 in numerous fuel adjustment clause audits, and played an active part in the formulation and
9 implementation of accounting staff policies with regard to rate case audits and accounting
10 issue presentations in Missouri. In 1979, I left the Missouri Public Service Commission to
11 start my own consulting business. From 1979 through 1985 I practiced as an independent
12 regulatory utility consultant. In 1985, Dittmer, Brosch and Associates was organized.
13 Dittmer, Brosch and Associates, Inc. changed its name to Utilitech, Inc in 1992.

14
15 My professional experience since leaving the Missouri Public Service Commission has
16 consisted primarily with issues associated with utility rate, contract and acquisition matters.
17 For the past twenty one years, I have appeared on behalf of clients in utility rate proceedings
18 before various federal and state regulatory agencies. In representing those clients, I
19 performed revenue requirement studies for electric, gas, water and sewer utilities and testified
20 as an expert witness on a variety of rate matters. As a consultant, I have filed testimony on
21 behalf of industrial consumers, consumer groups, the Missouri Office of the Public Counsel,
22 the Missouri Public Service Commission Staff, the Indiana Utility Consumer Counselor, the
23 Mississippi Public Service Commission Staff, the Arizona Corporation Commission Staff, the
24 Arizona Residential Utility Consumer Office, the Nevada Office of the Consumer Advocate,
25 the Washington Attorney General's Office, the Hawaii Consumer Advocate's Staff, the
26 Oklahoma Attorney General's Office, the West Virginia Public Service Commission
27 Consumer Advocate's Staff, municipalities and the Federal government before regulatory
28 agencies in the states of Arizona, Michigan, Missouri, Ohio, Florida, Colorado, Hawaii,

1 Mississippi, New Mexico, Nevada, New York, West Virginia, Washington and Indiana, as
2 well as the Federal Energy Regulatory Commission.
3

4 **Further Explanation of Various Recommendations**

5 Q. Turning to your first recommendation, please expand upon the need for the transfer of the
6 SLCWC CAM requirements to the Missouri-American Water Works Company.

7 A. In SLCWC Case No. WR-2000-844 the Office of the Public Counsel recommended, and this
8 Commission ordered, SLCWC to create and maintain a CAM regarding the allocation of
9 AWWSC costs to benefitting American Water Works Company subsidiaries. Among other
10 things, the ordered CAM requires SLCWC to document account numbers, titles and
11 descriptions of AWWSC accounts utilized; cost pools employed; locations of physical
12 activities undertaken; listing of subsidiaries exempt from AWWSC cost allocation and reasons
13 for exemption, explanation of reasonableness of allocation methodology employed; as well
14 as certain other statistics to be prepared on a calendar year ending basis. I have affixed as
15 Schedule No. 1 to this testimony, an excerpt of testimony which I filed on behalf of the
16 Missouri OPC in Case No. WR-2000-844 which contains the totality of recommendations
17 made, and support for, adoption of the CAM and certain other reporting requirements.
18

19 I have also affixed as Schedule No. 2 to this testimony excerpts from the recently issued
20 Missouri Public Service Commission order from Case No. WR-2000-844 wherein the OPC's
21 recommendations for creation and maintenance of a CAM were addressed. For all the
22 reasons given for SLCWC to create and maintain a CAM for AWWSC costs, it is equally
23 applicable that Missouri-American Water Company now undertake such task.
24

25 Q. Please expand upon your second recommendation that "downstream" documentation be
26 maintained for "districts" of Missouri-American Water Company comparable to that which
27 should be created regarding the allocation of AWWSC costs to each American Water Works
28 Company subsidiary.

1 A. It is my understanding that rates are established separately for the present Missouri-American
2 Water Company "districts." In other words, rates are established upon consideration of
3 individual district's rate bases and many directly-assigned operating expenses. Further, it is
4 my understanding that rates for SLCWC and JCWWC will continue to be established based
5 upon separate "district" rate bases and operating expenses for these newly created districts
6 following the proposed merger.

7
8 Since these old and newly-created districts will continue to have rates set individually (as
9 opposed to uniformly across the state), it is important to be able to assess the reasonableness
10 of "Missouri-allocated" AWWSC costs to each Missouri district. Accordingly, I am simply
11 recommending that the reasoning, support, statistics and rationale already required to be
12 documented in the MPSC-ordered CAM for AWWSC costs be, in turn, maintained
13 "downstream" to the Missouri district level.

14
15 Frankly, I believe my first two recommendations should have occurred even without further
16 specific Commission guidance. Indeed, I doubt that SLCWC would ever try to excuse itself
17 from the recently issued Commission order on the grounds that SLCWC, as a district, would
18 not receive a direct allocation of AWWSC costs as a result of its merger into Missouri
19 American Water Company which would somehow relieve it of the reporting requirements it
20 was ordered to carry out as a "subsidiary" of American Water Works Company. Further, it
21 is only logical to assume that the statistics of the various Missouri districts will be summed
22 to arrive the total Missouri-American Water Company statistics for use in allocating American
23 Water Works Service Company costs to Missouri-American Water Works Company. Finally,
24 it is difficult to envision that a different methodology would be employed to allocate AWWSC
25 cost to each Missouri district than was used to allocate AWWSC costs assigned to Missouri-
26 American Water Company.

1 In short and in summary regarding my first two recommendations, I believe it is logical,
2 consistent and not unduly burdensome to expect that the requirements already ordered for the
3 AWWSC CAM be extended "downstream" to the new and existing Missouri districts.
4

5 Q. Please expand upon your third point that, to the extent there are joint or common costs
6 incurred at the "Missouri American Water Company" level for the benefit of only the Missouri
7 "districts," comparable documentation to that being maintained for the AWWSC CAM also
8 be also created and maintained for such "common" Missouri costs.

9 A. In my review work in the SLCWC rate case I observed a limited amount of allocation of costs
10 in and among SLCWC and Missouri-American Water Company. In other words, to the
11 extent certain SLCWC employees performed work that was beneficial to Missouri-American
12 Water Company, part of the costs of such SLCWC employees were allocated to Missouri-
13 American Water Company. Conversely, to the extent certain Missouri-American Water
14 Company employees undertook tasks that were beneficial to SLCWC, part of the costs of
15 these employees were, likewise, allocated to SLCWC. It is logical to assume that there will
16 be some further "consolidation" of functions across the new and old Missouri-American
17 Water Company districts. With added consolidation of functions, it is important that the
18 reasonableness of "common Missouri" costs be documented. Accordingly, I am
19 recommending that the same reporting requirements regarding the allocation of AWWSC
20 costs to benefitting American Water Works Company *subsidiaries* be maintained for
21 "common Missouri" costs allocable to benefitting Missouri *districts*.
22

23 Just as it is important that Missouri-American Water Works Company receive only its
24 equitable share of AWWSC costs, similarly, it is important that each benefitting Missouri
25 district receive only its equitable share of "common Missouri" costs. To ensure efficiency
26 in the rate review process, it is important that the rate auditor be able to quickly achieve an
27 understanding of 1) the nature of any cost "pool," 2) the types of charges to a given
28 "common Missouri" cost pool, and 3) reasons for exemption from allocation of a "common
29 Missouri" cost pool, as applicable. Accordingly, it is my recommendation that documentation

1 for the allocation of "common Missouri" costs to Missouri districts be maintained in
2 comparable detail and format to that already being created for AWWSC charges to benefitting
3 American Water Works Company subsidiaries.
4

5 Q. Is it your recommendation that your various proposals be adopted as a condition to approval
6 of the merger?

7 A. Yes.
8

9 Q. Thank you.

**Excerpt from the Direct Testimony
of James R. Dittmer filed in
St. Louis County Water Company
Case No. WR-2000-844
on behalf of the
Missouri Office of the Public Counsel**

PROPOSED RECORD KEEPING REQUIREMENTS

Q. Please summarize your first recommendation to this Commission.

A. I am recommending that the Commission order SLCWC to prepare and maintain a Cost Allocation Model that clearly describes its methods of accumulating costs by various "pools" or categories, and which furthermore demonstrates and explains how such cost categories are allocated to benefitting American Water Works Company subsidiaries. Additionally, I am proposing that SLCWC/AWWC be required to prepare records or reports that will show the accumulation of costs by various allocation pools and the distribution of each pool's cost to benefitting subsidiaries.

Q. Why do you believe such recommendations are reasonable and necessary?

A. AWWC is a large corporate parent company that, as of the end of 1999, wholly owned 25 utility subsidiaries. Like many large utility holding companies, many functions and activities are carried out on a consolidated or centralized basis for the benefit of all or most of the subsidiaries. Such consolidated or centralized functions are carried out for the AWWC-owned subsidiaries by AWWC-wholly-owned American Water Works Service Company. Through a process of direct assignment and allocation, Service Company employees' time and related costs are ultimately charged to benefitting AWWC-owned utility subsidiaries.

While the process of direct assignment and allocation of Service Company costs is simple in concept, the intricacies of the actual applications are relatively complex. Furthermore, the costs flowing from the Service Company to SLCWC as well as other benefitting AWWC subsidiaries are significant. Given the magnitude and complexity of charges flowing from the Service Company to SLCWC, I believe it is imperative that:

- 1) a detailed Cost Allocation Manual be created and maintained, and
- 2) additional reports be prepared which will provide for more efficient analysis and review by rate auditors.

1 Q. You state that the amount of costs flowing from the Service Company to the AWWC water
2 utility subsidiaries is significant. What amount of Service Costs are at issue?

3 A. For calendar year 1999 the Service Company incurred more than \$36 million. In this case,
4 SLCWC is proposing to recover over \$2 million annually in Service Company expense within
5 its Missouri retail jurisdictional cost of service. Of course, while it is not at issue in this case,
6 Missouri-American Water Company also has several service territories in Missouri which are
7 also charged Service Company costs. Thus, the total amount of Service Company costs and
8 the amounts assigned or allocated to Missouri operations are significant and worthy of
9 regulatory review.
10

11 Q. By way of background, could you please briefly describe the functions and activities that are
12 undertaken by the Service Company on behalf of the AWWC-owned subsidiaries?

13 A. A number of services are offered by the Service Company, including the following:

14 Accounting	Human Resources
15 Administration	Information Systems
16 Communications	Operation
17 Corporate Secretarial	Rates and Revenues
18 Engineering	Risk Management
19 Financial	Water Quality

20

21 While all of the above-listed services are available to each AWWC subsidiary, not all the
22 subsidiaries require all of the services listed. This is as a result of the fact that several of the
23 subsidiaries apparently carry out some of these activities and functions, in part or in total, at
24 the local company level. It is the differing needs of the individual water subsidiaries that
25 contribute to the complexity and detail of understanding the distribution of Service Company
26 costs to benefitting subsidiaries.
27

1 Q. How are costs that are incurred at the Service Company distributed or charged to benefitting
2 water subsidiaries?

3 A. All Service Company costs are distributed to AWWC water utility subsidiaries through a
4 combination of direct assignment and allocation. It is my understanding that whenever a
5 Service Company employee works on a task or activity that exclusively benefits only one
6 subsidiary, such time and related payroll costs are directly assigned exclusively to the
7 benefitting subsidiary. However, if a task or activity benefits more than one subsidiary, such
8 time and related costs are said to be first assigned to a cost center or "pool" that is ultimately
9 allocated only to each benefitting subsidiary based upon the benefitting subsidiaries' number
10 of customers.
11

12 There are currently 19 different cost centers or "pools" established to consider 19 different
13 subsets of benefitting subsidiaries with 19 different sets of allocators. The 19 different cost
14 pools have benefitting subsidiaries that range in number from as few as three to as many as
15 27.
16

17 In addition to direct assignment and use of routinely-maintained cost pools, the Service
18 Company may also establish "projects" or "special authorizations" which may have unique
19 distributions beyond that provided within the routinely-maintained 19 cost pools.
20

21 Q. What do you observe or conclude with regard to the Service Company's method and process
22 of assigning and allocating costs to benefitting subsidiaries?

23 A. Within the following section of testimony I discuss concerns about the equity or
24 reasonableness of allocating *all* functions and activities on the basis of number of customers
25 served by each benefitting subsidiary. However, beyond this concern, I have no reason to
26 believe that there is anything inherently wrong with the method and process of allocating and
27 assigning Service Company costs to benefitting AWWC subsidiaries. In other words, if the
28 allocation/assignment process works as has been narratively described, it would appear to be
29 a reasonable process (again, with the possible exception of the allocation factor development

discussed in the next section). Therefore, my primary concerns in this case are not associated with the *concepts* of cost assignment stated to be in place. Rather, my concerns lie in the inability to efficiently verify that such processes are working as intended, and furthermore, assuming the processes are working as intended, the inability to determine whether the proforma level of expense being assigned to SLCWC is "normal" and/or "reasonable."

Q. Please explain.

A. To better understand my position, I would like first to describe what is readily available for review within the Service Company's currently-prepared reports. Specifically, SLCWC and/or the Service Company were able to provide me with the following:

Service Company General Ledger which delineates in some level of detail all expenses incurred by accounts established within the National Association of Regulatory Commissioners ("NARUC") Uniform System of Account for Class A and B Water Utilities ("USOA")

Detailed monthly Service Company invoices to SLCWC that show direct and allocated hours and dollars charged by function (i.e., accounting, administrative etc. listed above)

Total Service Company charges distributed to each benefitting subsidiary. Such charges are further delineated into the broad categories of: Management, Customer Billing, Water Testing, Specific Authorizations, Maintenance and Engineering. While these broad categories are summarized, one cannot observe the distribution by function (i.e., accounting, administration, etc.) nor can one observe what costs are being direct assigned versus allocated pursuant to any one of the 19 cost pools).

A listing of the individual utilities, their respective customer counts, and each subsidiary's calculated allocation factor associated with each of the noted 19 cost pools.

A listing of account titles and numbers utilized, as well as a brief description of items to be charged to, or recorded within, each account.

Q. What do you find lacking or deficient in what the Company was able to provide in the way of support for costs being assigned or allocated to SLCWC as well as other benefitting AWWC-owned subsidiaries?

1 A. First, while the Service Company's General Ledger will show the source of all charges to the
2 Service Company in total, it does not show the distribution of charges to benefitting
3 subsidiary - or even to the various cost pools before allocation to benefitting subsidiaries.
4 Accordingly, even if an auditor or a regulator should observe a potentially objectionable costs,
5 he or she would not know whether the objectionable costs is even being passed on to the
6 subsidiary of interest without further inquiry of the Company.

7
8 Second, while the auditor or the regulator can observe charges being directly assigned as well
9 as allocated to each benefitting subsidiary, one cannot determine what such costs consists of,
10 nor can one determine from which cost pool such charges have been allocated. Basically, the
11 detailed invoices to SLCWC show the flow of charges to SLCWC without offering very much
12 information as to why charges are being incurred or for what purpose.

13
14 Thus, costs incurred by cost pool are not summarized within any given report. As a result,
15 there is no linkage between costs being incurred (as delineated in some fashion within the
16 General Ledger) and costs being charged to each benefitting subsidiary (as delineated in some
17 detail on each subsidiary's invoice from the Service Company). In other words, there is no
18 linkage between detailed costs incurred and costs being assigned/allocated to a given water
19 utility being investigated.

20
21 Third, the basic understanding that I have achieved as to how Service Company costs are
22 being assigned or allocated to SLCWC, and what information is currently available, had to
23 be gleaned from review of several data requests as well as several phone discussions with a
24 Company rate representative. In making such assertion, I do not mean to confer that the
25 Company has been uncooperative or unwilling to provide information. Rather, my criticism
26 lies in the fact that there is no one place to observe and gain an understanding of how the
27 various books and records are maintained, what information is available, and ultimately, how
28 the benefitting subsidiaries are being charged for services provided.

1 Q. Given your criticisms, what specific reporting or record keeping requirements are you
2 recommending that this Commission order in this case -- assuming SLCWC/AWWSC do not
3 voluntarily agree to prepare and maintain such requested items?

4 A. First, I would recommend that SLCWC be required to secure and maintain an up-to-date Cost
5 Allocation Manual ("CAM") on behalf of the Service Company which provides various
6 services to the AWWC subsidiaries or affiliates. At a minimum, I would expect such CAM
7 to contain the following:

- 8 1. Listing of accounts including account numbers and descriptive titles, as well
9 as a description of charges to be recorded within each account.
- 10 2. A copy of all contracts or service agreements between any and all AWWC
11 affiliates and subsidiaries -- including the Service Company. If many of the
12 agreements are identical in nature, one sample copy would suffice. Also, if
13 the various contracts and agreements are voluminous, a description of their
14 availability and locations should, at a minimum, be included within the CAM.
- 15 3. Listing of cost pools employed, a description of the physical location(s)
16 wherein pool functions/activities take place, a description of the various types
17 of activities and functions taking place within each given cost pool, and an
18 up-to-date table showing which subsidiaries benefit from each given pool as
19 well as which subsidiaries are exempt from being allocated charges from any
20 given cost pool (i.e., the table should also show a listing of subsidiaries which
21 do not benefit from the pool).
- 22 4. For each subsidiary that is exempt from being allocated costs from a given
23 pool, a definitive statement that such subsidiary does not benefit from
24 functions being provided by the cost center in question should be included
25 within the Cam. Furthermore, the CAM should include a brief explanation
26 as to how each subsidiary which is exempt from a given pool's cost
27 allocation accomplishes the functions which are provided by the pool.
- 28 5. A listing of each non-AWWC-owned company, municipality or entity which
29 receives goods or services from the Service Company or any other AWWC-

1 owned subsidiary or affiliate as well as a description of the goods and
2 services provided. Additionally, the CAM should include a description and
3 detailed example, as applicable, of the method of determining how goods or
4 services provided are priced or charged. Finally, a copy of any contract or
5 service agreement with each such independent entity should be included in
6 the CAM – or in the alternative simply listed and referenced as to location
7 and availability.

- 8 6. For any good or service that is charged to an operating company based upon
9 a routinely-applied allocation factor, such allocation scheme should be
10 supported as to reasonableness, applicability and equity. In many instances,
11 such explanations would be brief and nearly self-evident as to reasonableness.
12 For instance, a brief statement that customer billing costs are allocated based
13 upon number of customers because such costs are understood to be driven
14 primarily by customer counts would be all that would need to be documented
15 in the CAM. Obviously, other allocation applications could be more detailed
16 and complicated in nature, thus requiring greater explanation and support.
- 17 7. Tables detailing allocation factors derived from latest-calendar-year-ending
18 statistics which would include, but not necessarily be limited to:
- 19 a. Direct payroll charged by each AWWC-owned operating company
 - 20 b. Revenues received by each AWWC-owned operating company
 - 21 c. Net investment in utility plant
 - 22 d. Investment in net utility plant and investment in non-utility properties
 - 23 e. Direct operation and maintenance expense charged to each AWWC-
24 owned operating company

25 The benefits and necessity of requiring that such allocation factors be filed
26 within the CAM are discussed within the following section of testimony.

- 27 8. A listing and sample copy of all routinely-prepared reports as well as a
28 narrative description of all data included on each such report.

- 1 9. Description of AWWC's or AWWSC's capabilities and availability to
2 generate unique or customized reports from existing data bases.
3 10. A compendium of accounting guidelines currently in place.
4

5 Q. Has this Commission previously endorsed implementation of Cost Allocation Manuals?

6 A. Yes. Approximately one year ago, the Missouri Public Service Commission issued an order
7 adopting rules regarding affiliate transactions for all utilities providing regulated electric,
8 natural gas and steam heating service in Missouri. The rules affecting each noted utility group
9 contain a provision requiring an up-to-date Cost Allocation Manual. Thus, my
10 recommendation to create and maintain a Cost Allocation Manual is neither new nor unique
11 to Missouri regulation. Indeed, SLCWC would represent "the exception" to the rules being
12 applied to the majority of utilities operating in the State of Missouri.
13

14 Q. What are the benefits of creating and maintaining an up-to-date cost allocation manual?

15 A. I believe the benefits are both numerous and obvious. First, I would note that annual
16 maintenance of a CAM would effectively force management and AWWC accountants to
17 "rethink" the equity and logic of various cost assignment/allocation schemes in place. In other
18 words, by consciously reviewing existing policies and considering changed circumstances
19 before committing procedures "to writing" within the CAM, management would be indirectly
20 encouraged to review the adequacy, equity and reasonableness of cost
21 assignment/distribution policies in place.
22

23 Second, such document would significantly streamline, abbreviate and enhance the regulatory
24 review process. It would seem that the minimum information that I have recommended be
25 included in the CAM would be of interest to any regulatory body or its staff that is attempting
26 to assess the reasonableness of Service Company charges being included within any given
27 subsidiary's jurisdictional cost of service. Indeed, over the long run, it would seem possible
28 – if not probable – that creation and maintenance of such document would reduce regulatory
29 costs as information that is probably routinely requested and responded to in a multitude of

1 jurisdictions on an ad hoc basis would be assembled in one up-to-date document. In other
2 words, it seems possible that the cost of maintenance of such a document may be less than
3 the recurring cost of responding to duplicative and recurring discovery requests in water rate
4 applications occurring through out AWWC's various service territories.

5
6 Q. If that concludes your comments on the need for, and items to be included within, a Cost
7 Allocation Manual, please continue by discussing the various reports that you are
8 recommending be created and maintained for review by rate auditors.

9 A. As discussed in some detail earlier, there is basically a void – or lack of linkage – between
10 costs being incurred by the Service Company and costs being assigned or allocated to the
11 various water utility subsidiaries. Accordingly, I am basically recommending that reports be
12 created that will bridge the span between what costs are being incurred and what costs are
13 being charged – in this particular case – to SLCWC.

14
15 Specifically, I am recommending that two different reports be generated. First, I believe it
16 would be most beneficial to be able to observe costs being incurred by source in each
17 allocation pool. Second, I would recommend that a report be generated that shows the
18 distribution of costs in each allocation pool to all benefitting subsidiaries.

19
20 Q. Would such reports provide the necessary linkage between costs being incurred at the Service
21 Company and costs being assigned to each benefitting subsidiary?

22 A. Yes. And just as importantly, creation of such reports would allow for the analysis of trends
23 by activity or cost center. Identification of such trends, in conjunction with the ability to
24 observe the distribution of costs by pool, would better facilitate the development of
25 appropriate rate case adjustments. Additionally, it would seem that such reports would
26 facilitate better budgeting techniques and budget variance reporting.

27
28 Q. Will the recommendations which you are proposing cause the Service Company to create data
29 which does not currently exist?

1 A. I believe all the data currently exists. The costs are already accumulated by pool before
2 distribution to benefitting subsidiaries. Furthermore, the distribution of pool costs obviously
3 already occurs for invoicing purposes. It is the assemblage of available data in a more
4 meaningful, useful or "friendly" format that does not exist. What I am proposing is a
5 programming effort to assemble existing data in a format that would be more useful to
6 auditors - and possibly the Company's own budgeting department.

7
8 Q. What efforts or steps would have to be undertaken for an auditor to obtain the information
9 that you are recommending that the Service Company be required to report on a regular
10 basis?

11 A. My understanding is that costs are not aggregated by the noted 19 different pools in any
12 regularly prepared report. If that is correct, it would appear that an auditor would have to
13 review the monthly multi-page invoice support prepared for each of the AWWC-owned
14 operating companies and sum the various line items shown on each invoice to arrive at a total
15 for cost for each pool. I am not certain what steps would have to be undertaken in an attempt
16 to link or associate costs quantified by pool back to the General Ledger or any Sub Ledger
17 that may be in existence.

18
19 Q. In an earlier answer, you stated in part that the reporting requirements you are recommending
20 may actually facilitate better budgeting techniques. What is the basis of such statement?

21 A. Currently there is no linkage between the total Service Company budget and the amounts of
22 Service Company costs budgeted by each subsidiary to be incurred. Specifically, a total
23 Service Company budget is prepared annually. Additionally, each subsidiary prepares its own
24 budgeted amount of Service Company costs that it expects to incur in the next fiscal period.
25 However, the individual subsidiary's budgeted Service Company cost is not linked to, affected
26 by, or dependant upon what the Service Company budgets to incur on a total Company basis.
27 I believe this disjoint in the two budgeting processes highlights the void that rate auditors also
28 face when trying to bridge the gap between total Service Company costs and Service
29 Company costs being charged to a particular subsidiary of interest. Thus, while I am not

1 making linkage between individual subsidiaries and total Service Company budgets a
2 necessary element of my proposal, I do believe that such linkage in the reporting process
3 could lead to better development and control in the budgeting process.
4

5 Q. Would you please summarize why you believe your recommendations for maintenance of a
6 CAM and additional reports is reasonable and necessary?

7 A. The amount of Service Company costs being proposed for recovery through Missouri
8 jurisdictional retail rates is significant. In this case over \$2 million of Service Company costs
9 are being requested for recovery. The amount requested for recovery in this case would be
10 in addition to what is already being recovered in rates from Missouri-American Water Works
11 Company customers.
12

13 While the concepts of what the Service Company attempts to do in the way of distributing
14 costs fairly and equitably are simple, the application of such concepts becomes quite complex.
15 Accordingly, I believe the creation and maintenance of a CAM as well as the additional
16 reports that I have recommended will facilitate a faster and better understanding of costs
17 being assigned and allocated to Missouri retail operations. Furthermore, the reports that I
18 have recommended be prepared will facilitate more meaningful review or analysis and should
19 facilitate faster identification of trends and/or requirement for rate case normalization and
20 annualization adjustments.
21
22

Reasonableness of Allocating All Non-Direct-Assigned Service Company Costs on the Basis of Each Operating Company's Number of Customers

Q. In the previous section of testimony you stated that all Service Company costs that were not directly assigned to a specific operating company were allocated on the basis of the number of customers served by each subsidiary that was benefitting from a stated function. Do you believe that customer counts are the proper basis for allocating all such Service Company costs that have not been directly assigned?

A. No. While cost incurrence for certain functions or activities can be largely or primarily attributable to customer counts, there are clearly other activities undertaken whose costs are more directly influenced by other factors - such as investment, revenues, number of employees or direct operation and maintenance expense - just to name a few.

Q. Are you proposing to adjust Service Company costs being allocated to SLCWC in this case based upon different allocation methodologies?

A. No, for a number of reasons.

Q. Please explain.

A. First and foremost, the data necessary to perform calculations that would lead to such an adjustment is not available, or efficiently/economically available, at this point in time. Assuming the analyst had a strong belief that a particular cost center should be allocated on the basis of, say, direct payroll expense rather than customer counts as used by SLCWC/AWWSC, I am not aware of where various costs by pool may be maintained. Specifically, as discussed within the first section of my testimony, I am not presently aware of where and if total costs by "pool" or "cost center" are maintained. In other words, one could calculate a preferred allocation factor - in the case of this example -- based upon direct payroll expense. However, one cannot determine, or cannot determine without a great deal of data gathering, how much of a given cost center has been allocated to SLCWC on the basis of number of customers.

1 Second, my analysis to date is not sufficiently complete to determine what the appropriate
2 allocator should be for all cost centers. Furthermore, as I shall elaborate upon in an ensuing
3 section of testimony, preliminary analyses performed to date suggests that both SLCWC as
4 well as Missouri-American Water Company are being over charged by virtue of allocating all
5 non-direct-assigned Service Company costs on a customer count basis.

6
7 Third, refinement of the allocation process will undoubtedly add some level of complexity and
8 administrative cost to the allocation scheme now in place. I believe the administrative costs
9 will be modest relative to the swings in cost assignment to the various benefitting operating
10 companies. However, it would be reasonable to question and discuss what efforts would have
11 to be undertaken, and what costs incurred, to implement the allocation changes that I am
12 suggesting. Additionally, further sensitivity analysis and testing could be undertaken to check
13 the range of possible allocation outcomes before committing to a complete change.

14
15 Finally, SLCWC was only recently acquired by AWWC. There are only a limited number of
16 months experience with SLCWC being owned by AWWC and served by AWWSC.
17 Accordingly, the Company has used a simplified method to annualize ongoing Service
18 Company costs based upon charges assigned and allocated to SLCWC during the first four
19 months of calendar year 2000. I believe it would be more appropriate to revisit the issue of
20 allocation methods when additional months of "normal" operations have transpired and are
21 available for review and analysis.

22
23 Q. Have you reviewed allocation schemes employed by other utility companies that own several
24 subsidiaries and/or operating divisions to determine how other companies assign or allocate
25 corporate overhead costs that are similar or identical to costs incurred by AWWSC?

26 A. Yes. Two somewhat-similar organizations come immediately to mind. Specifically, here in
27 Missouri, I have reviewed UtiliCorp United's ("UCU") cost distribution process for common
28 corporate overhead costs. Additionally, I have reviewed Citizens Utilities Company's
29 ("CUC") process for assigning and allocating joint or common costs to utility properties that

1 it owns and operates in several different states. Like AWWC, both UCU and CUC own
2 utility properties in numerous different states but carry out a number of corporate office
3 functions on consolidated and centralized basis.
4

5 Q. How do other diversified utility companies' cost allocation processes compare to AWWSC's
6 process for distributing costs?

7 A. Of the two utilities just mentioned, both directly assign employees' time and costs whenever
8 it is possible to assign such resources to a particular benefitting operating company. At least
9 at the time of UtiliCorp United/Missouri Public Service's last rate case, UCU also allocated
10 certain specific costs based upon unique allocation factors. For instance, at the time of
11 UCU's last rate case, UCU allocated certain payroll accounting costs based upon the number
12 of employees of each benefitting division. In other words, sometimes the cost of a specific
13 function would be allocated based upon a factor that considered the specific cost causative
14 characteristics of the activity undertaken.
15

16 In the case of UCU and Citizens Utilities, all remaining or "residual costs" - or costs that
17 were not directly assigned or allocated upon a unique and specific allocation factor - were
18 allocated based upon a composite allocation factor that considered three or four different
19 elements. Specifically, Citizens Utilities allocated "residual costs" based upon a simple
20 average of direct- assigned plant, direct-assigned operations and maintenance expense,
21 number of customers and direct payroll of the various properties or subdivisions benefitting
22 from such residual activities. In the case of UCU, "residual costs" were allocated on the basis
23 of a simple average of revenue margins, direct-assigned payroll expense and investment in
24 plant/non-utility property. In other words, unlike AWWSC which allocates all "residual
25 costs" on a customer count basis, each of the two noted utilities allocated "residual" or non-
26 direct-assigned costs on the basis of a factor that considered numerous elements.
27

28 Q. Do you know if AWWSC has ever allocated common or residual costs on a basis other than
29 customer counts?

1 A. According to the Company's response to Public Counsel's Data Request No. 1091, prior to
2 1989 Service Company costs were allocated upon a multitude of factors including number of
3 employees and net plant investment.
4

5 Q. You have stated that two similarly-situated utilities have used composite allocation factors
6 for distributing residual common costs. You have also just stated that AWWSC has
7 previously used a different allocation process than what is presently being used. Do such
8 findings lead you to believe that there may not be one most precise or most equitable method
9 of allocating costs that have not been directly assigned?

10 A. I would agree that allocating residual costs is not a precise science. Reasonable professionals
11 may not always agree as to the best method to allocate residual costs. That said, however,
12 I do believe that AWWSC/SLCWC are in the minority by virtue of their use of customer
13 counts as the only factor to allocate all residual costs. Furthermore, while there may be
14 different supportable views as to which components should be considered within the
15 development of a "composite allocator" to apply to residual costs, I do believe most would
16 agree that some form of composite factor would be superior to use of a factor that only
17 considers customer counts.
18

19 Q. Why do you believe application of some form of "composite allocator" to residual corporate
20 costs is more equitable or reasonable than rigid adherence to a customer count allocator?

21 A. The goal of the regulator and the accountant should be to distribute costs based upon a
22 method that most accurately assigns a given cost to the business units that are causing the
23 costs to be incurred or which are benefitting from the activity undertaken. Of course,
24 whenever possible, direct assignment is the most equitable distribution method. However,
25 with a large holding company like AWWC, numerous activities are undertaken on a
26 consolidated basis for the benefit of several subsidiaries. In those instances, it is not possible
27 to directly assign all costs to each benefitting subsidiary. When direct assignment is not
28 possible, an allocation method should be employed that most accurately considers the cost
29 causative nature of the activity - or the value derived by each benefitting subsidiary. For

1 many activities there is wide spread acceptance between an activity and its related costs and
2 an appropriate or acceptable method of allocating such costs to benefitting entities. For
3 instance, the following activities are commonly allocated on the following bases – both in
4 corporate overhead allocation schemes as well as in jurisdictional and class cost of service
5 studies.

<u>Activity</u>	<u>Allocation Method</u>
Customer Accounting and Customer Billing	Number of Customers or Meters
Employee Benefits and Human Resources	Payroll Costs or Number of Employees
Franchise Taxes	Revenues

14 The equity of allocating the above costs on the noted bases is fairly obvious and seldom
15 challenged. However, for a number of other activities, it far less obvious as to what entity,
16 event or activity is contributing the most to the cost incurrence. Because it is difficult if not
17 impossible to determine a relationship between certain costs being incurred and an event,
18 activity or investment causing or contributing to the costs being incurred, diverse holding
19 companies frequently develop a composite allocation factor to distribute such "residual costs."
20 The composite allocation factor – which may equally consider items such as revenues, direct
21 O&M, direct payroll, customer counts and investment – effectively recognizes that it is
22 impossible to attribute certain costs to any one event or activity. Accordingly, such residual
23 costs are allocated on the basis of general composite allocator that considers a number of
24 statistics and activities.

25
26 Q. You stated that you had performed preliminary analysis that leads you to conclude that both
27 SLCWC as well as Missouri-American Water Company are being over charged by virtue of
28 allocating all non-direct-assigned Service Company costs on a customer count basis. Please
29 elaborate upon the analysis you have performed regarding use of other allocation factors.

1 A. I requested SLCWC to provide statistics regarding revenues, direct payroll and investment
2 in plant and non-utility property for the twelve months ending June 30, 2000 for all of the
3 AWWC-owned operating companies - including SLCWC as well as Missouri-American
4 Water Company. For obvious reasons, I believed it was important to analyze any
5 contemplated or proposed change in allocation methodologies upon all Missouri-regulated
6 American Water Works Company subsidiaries. As shown on the table below, in virtually
7 every instance, employment of an allocation factor developed on a basis other than customer
8 counts would lead to a lower allocation of residual costs to SLCWC and Missouri-American
9 Water Company:

Company	Customer Allocator (Presently Used by AWWSC)	Revenue Allocator	Payroll Allocator	Plant & Non-Utility Investment	Composite Allocator Based on Revenues, Payroll & Investment
SLCWC	11.96%	8.74	11.66%	8.49%	9.63%
Missouri-American	3.74%	2.44%	2.30%	3.77%	2.84%
Combined SLCWC & Missouri-American	15.70%	11.18%	13.96%	12.26%	12.47%

18 As shown above, in all but one comparison, use of a customer-based allocation factor leads
19 to a higher allocation of costs to SLCWC, Missouri-American and combined
20 SLCWC/Missouri-American than does any other allocation methodology shown.

21
22 Q. Reviewing the table above, one can observe that use of other allocation methodologies would
23 result in approximately one percent (1.0%) to three percent (3.0%) less AWWSC costs being
24 allocated to SLCWC or Missouri-American Water Company. Would such a reduction be all
25 that significant?

1 A. Very much so. Under the current allocation process employed, combined SLCWC and
2 Missouri-American Water Company are allocated 15.70% of the Service Company's residual
3 costs. If AWWSC would, for instance, adopt a composite allocator based upon revenues,
4 payroll and investment, the combined SLCWC/Missouri-American entity would only be
5 allocated 12.47% of the Service Company's residual costs - or 3.19% less than what is
6 occurring with use of the customer allocator. The 3.23% reduction, while seemingly modest
7 in terms of an absolute percentage, would be very significant in terms of impact to the
8 combined entity. Specifically, all other things equal, a reduction from 15.70% of residual
9 Service Company costs down to 12.47% would result in a twenty percent (20%) reduction
10 in Service Company costs being allocated to the combined SLCWC/Missouri-American
11 Water Company entity. (Calculated as follows: 1 minus [12.47% divided by 15.70%] equals
12 20%).
13

14 Q. Did you inquire of SLCWC as to why it believed that customer counts were the most
15 appropriate consideration for allocating residual corporate overhead costs?

16 A. Yes. In Public Counsel Data Request No. 1076 we asked:

17 Please state all reasons why it is believed or thought that number-of-
18 customers is the best or most equitable basis for allocating all non-direct-
19 assigned Service Company costs to benefitting AWWC subsidiaries.
20

21 The totality of the Company's response stated:

22 Number-of-customers is used because it is a straightforward way to
23 administer costs and is easy to understand the allocations.
24

25 In Public Counsel Date Request No. 1075 we also asked:

26 Please provide any studies or analyses undertaken within the last five years
27 which address the reasonableness or equity of allocating all non-direct-
28 assigned Service Company costs on the basis of number of customers served
29 by each benefitting AWWC subsidiary.
30

31 The Company's response stated that no studies had been performed.
32

1 Q. Does you believe the Company's support and rationale for employment of customer counts
2 as a basis for allocating all residual costs is adequate for continued application without further
3 study?

4 A. No. Ease in administration and the "straightforwardness" in administering maybe
5 considerations when determining what allocation methods to ultimately employ. Additionally,
6 as previously mentioned in this testimony, it may be appropriate to weigh incremental costs
7 to achieve a more refined allocation process against the precision and equity that would likely
8 result from such a change.

9
10 Frankly, I was surprised to observe the significant disparity in allocation factors for SLCWC
11 and Missouri-American Water Company that were derived from the above-noted differing
12 allocation methodologies. Had the difference between allocation factors derived from
13 customer counts and other allocation factors derived from considering revenues, direct payroll
14 and investment not been so significant, I may not be recommending so adamantly that a
15 change be studied or employed. However, given that there is a significant disparity in the
16 noted allocation factors, and that the Company has not studied the equity or applicability of
17 allocating all residual costs on a customer-count basis for at least five years, I believe it is
18 reasonable, desirable, equitable, and indeed essential, to study and address a change at this
19 point in time.

20
21 Q. Would you please reiterate and summarize your specific recommendation regarding study
22 and/or employment of allocation factors to be used in assigning residual costs to benefitting
23 subsidiaries?

24 A. As noted earlier, my only specific recommendation is that SLCWC be ordered to develop a
25 Cost Allocation Manual. With regard to this issue, I am recommending that for any good or
26 service that is charged to an operating company based upon a routinely-applied allocation
27 factor, such allocation scheme should be supported as to reasonableness, applicability and
28 equity. It is not my recommendation that SLCWC be unconditionally ordered to change or
29 switch from allocating residual costs on a customer count basis. However, should SLCWC

1 continue to support strict and universal adherence to customer counts as the basis for
2 allocating all residual costs, I would expect such proposal to be supported by studies or
3 analyses that consider the nature of various costs and activities undertaken and the estimated
4 impact to all the various operating companies from modifying the current allocation
5 methodology to other methods considered. Of course, the Company would be free to present
6 any arguments which it believes are relevant to continued use of the current customer-count
7 allocation methodology (i.e., "straightforwardness," ease in understanding, etc.). However,
8 if the primary argument for continued use of the customer-count allocation method is "ease
9 in administering," I would expect such argument to be supported by detailed analyses of the
10 cost and complexity of changing to other processes and methodologies.

11
12 Additionally, I am recommending that tables detailing allocation factors derived from latest-
13 calendar-year-ending statistics also be included within the CAM. The purpose of such
14 documentation would be to allow the Commission, its Staff, Public Counsel as well as other
15 Intervenor to assess the probable impact of utilizing other allocation methodologies. With
16 such tables, as well as the other information being provided within the CAM, such parties
17 could assess the reasonableness of what SLCWC has proposed against the equity and likely
18 impact of changing to other allocation methodologies.

19
20 Q. Could you briefly summarize the reasons why you believe your recommendations regarding
21 allocation support to be included within a Cost Allocation Manual are reasonable and
22 necessary?

23 A. First, the Company has apparently not studied the equity or reasonableness of its current
24 allocation methodology in any recent time period. Its stated support for its current customer-
25 count allocation basis is cryptic, at best.

26
27 Second, while I have not performed a detailed analysis of activities undertaken at AWWSC
28 that are allocated on a customer-count basis, based upon brief AWWSC department
29 descriptions as well as my general understanding of "corporate" activities that typically take

1 place on a consolidated basis by parent companies such as AWWC, I believe that it is
2 intuitively obvious that not all such costs should be most equitably allocated on a customer-
3 count basis.
4

5 Third, based upon preliminary analyses discussed in this testimony, it is probable that Missouri
6 customers served by SLCWC and Missouri-American Water Company are, or soon will be,
7 significantly over charged utilizing the present methodology. Thus, preliminary analyses
8 would suggest that continued universal use of customer-counts for allocating residual costs
9 cannot be defended by claims of "immateriality" if AWWSC were to adopt new or different
10 methodologies.
11

12 Fourth, ordering SLCWC to prepare and support a Cost Allocation Manual would be
13 consistent with Missouri energy utilities' requirement to similarly undertake such steps
14 pursuant to rulemakings adopted by this Commission approximately one year ago..
15

16 Finally, what I am recommending be merely studied (i.e., employment of activity-specific or
17 composite allocation factors) is not new, radical or unique in application. Indeed, while I
18 have not studied or surveyed how all various utility holding companies allocate "corporate",
19 "common" or "overhead" costs, based upon my personal experience, I believe that AWWSC
20 is probably in the minority by employing a customer-count allocator for distributing all
21 residual costs. For all the noted reasons, I believe it is fitting and necessary to order SLCWC
22 to prepare and support a Cost Allocation Manual at this point in time.
23

**Excerpt from Missouri Public Service Commission
Order Dated May 3, 2001
in Case No. WR-2000-844 for
St. Louis County Water Company**

what it believes to be favorable regulatory treatment of its expected costs.

The Company's proposal in this case is more detailed than its past proposals. The Company proposes to increase infrastructure spending over the next three years, with an annual revenue requirement increase from this spending of approximately \$2 million in 2001, \$4.5 million in 2002, and \$7.9 million in 2003. The average over the three years is approximately \$4.8 million. The annual budget for infrastructure replacement for these years is \$9 million in 2001, \$15 million in 2002, and \$20 million in 2003.

The Company submitted the "Weston Report" which outlines a relatively comprehensive economic analysis of the planned main replacements. In Exhibit 80, admitted at the hearing over the objections of Staff and Public Counsel, the Company added more details to its proposal. The Company offered to commit to replacing certain mains within certain time periods and to make refunds to customers if those commitments were not met. Alternatively, the Company offered to use its best judgment in deciding whether the proposed main replacements should be modified and to allow that judgment to be subject to prudence reviews.

4.B. Should the Company be required to maintain a cost allocation manual and certain other information and reports concerning expenses charged to the Company by the American Water Works Service Company?

AWK, in addition to owning utilities that provide water service to customers, owns a service company that provides service to its water utilities. Public Counsel witness Dittmer proposes that the Company be required to prepare and maintain a cost allocation manual (CAM) that describes the methods American Waterworks Service Company (AWWSC) uses to accumulate or categorize costs and describes how these costs are

allocated to AWK subsidiaries. Mr. Dittmer proposes that the CAM include the following information:

1. Listing of accounts including account numbers and descriptive titles, as well as a description of charges to be recorded within each account.

2. A copy of all contracts or service agreements between any and all AWWC affiliates and subsidiaries - including the Service Company. If many of the agreements are identical in nature, one sample copy would suffice. Also, if the various contracts and agreements are voluminous, a description of their availability and locations should, at a minimum, be included within the CAM.

3. Listing of cost pools employed, a description of the physical location(s) wherein pool functions/activities take place, a description of the various types of activities and functions taking place within each given cost pool, and an up-to-date table showing which subsidiaries benefit from each given pool as well as which subsidiaries are exempt from being allocated charges from any given cost pool (i.e., the table should also show a listing of subsidiaries which do not benefit from the pool).

4. For each subsidiary that is exempt from being allocated costs from a given pool, a definitive statement that such subsidiary does not benefit from functions being provided by the cost center in question should be included within the CAM. Furthermore, the CAM should include a brief explanation as to how each subsidiary which is exempt from a given pool's cost allocation accomplishes the functions which are provided by the pool.

5. A listing of each non-AWWC-owned company, municipality or entity included within the CAM which receives goods or services from the Service Company or any other AWWC-owned subsidiary or affiliate as well as a description of the goods and services provided. Additionally, the CAM should include a description and detailed example, as applicable, of the method of determining how goods or services provided are priced or charged. Finally, a copy of any contract or service agreement with each such independent entity should be included in the CAM - or in the alternative simply listed and referenced as to location and availability.

6. For any good or service that is charged to an operating company based upon a routinely-applied allocation factor, such allocation scheme should be supported as to reasonableness, applicability and equity. In many instances, such explanations would be brief and nearly self-evident as to reasonableness. For instance, a brief statement that customer billing costs are allocated based upon number of customers because such costs are understood to be driven primarily by

customer counts would be all that would need to be documented in the CAM. Obviously, other allocation applications could be more detailed and complicated in nature, thus requiring greater explanation and support.

7. Tables detailing allocation factors derived from latest-calendar-year-ending statistics which would include, but not necessarily be limited to:

- a. Direct payroll charged by each AWWC-owned operating company;
- b. Revenues received by each AWWC-owned operating company;
- c. Net investment in utility plant;
- d. Investment in net utility plant and investment in non-utility properties;
- e. Direct operation and maintenance expense charged to each AWWC-owned operating company.

The benefits and necessity of requiring that such allocation factors be filed within the CAM are discussed within the following section of testimony.

8. A listing and sample copy of all routinely-prepared reports as well as a narrative description of all data included on each such report.

9. Description of AWWC's or AWWSC's capabilities and availability to generate unique or customized reports from existing data bases.

10. A compendium of accounting guidelines currently in place.

The Company is allocated millions of dollars annually from AWWSC. Mr. Dittmer states that the CAM will allow the Commission to evaluate whether these allocated costs are appropriate. All of the data the CAM would encompass currently exists.

The Company asserts that Mr. Dittmer's proposal takes a different approach than does the Commission's rules on affiliated transactions. It also claims that it will be costly and time-consuming to prepare a CAM like the one Mr. Dittmer proposes. However, it did not produce any evidence to quantify either the time or cost involved.

Conclusions of Law

1.B.(1) What is the appropriate manner in which to treat net salvage?

While Staff criticizes Mr. Stout's estimates of net salvage costs in general, it does not note any specific problem with any specific

replacements, and to ensure that main replacements occur at the rate the Company believes is appropriate, the Commission will order the Company to set a certain level aside in a depreciation fund and to expend them only for main replacements. The Commission will require the Company to segregate depreciation expense recoveries in a depreciation fund sufficient to fund main replacements at the average level proposed by Company witness Salser in Schedule JES-1 to Exhibit 47.

4.B. Should the Company be required to maintain a cost allocation manual and certain other information and reports concerning expenses charged to the Company by the American Water Works Service Company?

The Commission agrees with Public Counsel that there should be information available for interested entities and the Commission to evaluate the costs the Company is allocated from AWWSC. The CAM described by Mr. Dittmer will be a very effective tool in this evaluation, and the Commission will order the Company to prepare and maintain such a CAM.

The Company points out that the Commission considered establishing affiliate transaction rules for the water industry, but decided against it. It argues that the Commission's decision not to implement these rules means that it should not require the Company to maintain a cost allocation manual. This argument has little merit. Simply because the Commission found no need to impose affiliate transaction rules on the water industry as a whole does not mean that there is no reason to be concerned about the Company's transactions with its affiliates. The Company's argument that the approach taken in Public Counsel's proposed CAM is different than the approach taken in the Commission's affiliate transaction rules is similarly misplaced. The focus of the CAM ordered here is much narrower than the rules; it is designed to provide

information about the allocation of costs from a service-company affiliate. Finally, the Commission is unpersuaded by the Company's claims that the CAM will be costly and time-consuming to produce since the Company did not quantify either the time or the cost.

Pending Matters

On November 17, 2000, Public Counsel filed a motion for leave to late-file the direct testimony of its witness Dittmer. No party opposed that motion and it will be granted.

On January 16, 2001, the Staff filed a motion for leave to late-file the proposed list of issues. No party opposed that motion and it will be granted.

On January 29, 2001, the parties filed a Stipulation and Agreement as to Rate Design. Although the agreement was not unanimous, no party opposed it and the Commission will treat it as unanimous pursuant to 4 CSR 240-115. The Commission finds the agreement to be reasonable and will approve it.

On April 5, 2001, Staff filed a motion for leave to late-file its brief. No party opposed that motion and it will be granted.

IT IS THEREFORE ORDERED:

1. That the tariff sheets filed by St. Louis County Water Company d/b/a Missouri-American Water Company on June 23, 2000, and assigned tariff number 200001199, are rejected.
2. That St. Louis County Water Company d/b/a Missouri-American Water Company is hereby authorized to file proposed tariff sheets in compliance with this Report and Order.
3. That St. Louis County Water Company d/b/a Missouri-American Water Company shall establish a depreciation fund as described herein.